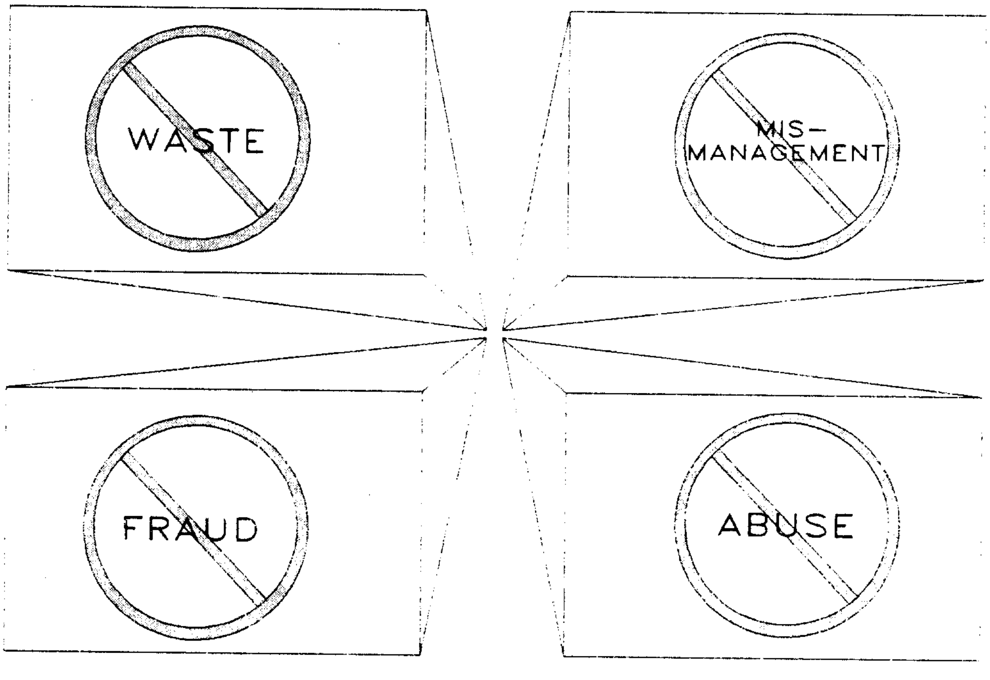
U.S. Department
of Transportation
United States
Coast Guard

INTERNAL CONTROL SYSTEMS PROGRAM

PROGRAM INTEGRITY OMB A-123


WASTE
MIS-MANAGEMENT
FRAUD
ABUSE

COMDTINST M5700.8

U.S. Department
of Transportation
**United States
Coast Guard**

Commandant (G-CCS-2)
United States Coast Guard

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COMDTINST M5700.8

5 AUG 1991

COMMANDANT INSTRUCTION M5700.8

Subj: Internal Control Systems Program

1. PURPOSE. This instruction assigns responsibilities and provides policies and procedures concerning the assessment and evaluation of Coast Guard internal control systems. This instruction applies to all Coast Guard civilian and military personnel.

2. DISCUSSION. OMB Circular A-123, Internal Control Systems (revised 8/14/86) provides policy and procedure for agencies to establish and maintain a cost-effective system of internal controls. It requires each agency to develop a five year Management Control Plan (MCP) to plan and direct the process for reviewing risk, and identifying and correcting material weaknesses in internal control systems. Coast Guard must annually revise the MCP. The new OMB guidance encourages more flexible review of control systems by using risk assessments and alternative internal control reviews to provide reasonable assurance that resources are protected against fraud, waste, abuse, or mismanagement.

3. RESPONSIBILITIES.

   a. Commandant (G-CCS-2) will:

      (1) serve as the Coast Guard Internal Control Officer,

      (2) segment the Coast Guard's program, administrative, and financial functions into assessable components,

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(3) forward the appropriate listing of assessable components to respective Headquarters and field units under separate correspondence,

(4) initiate and coordinate the risk assessment process for assessable units,

(5) assign and schedule internal and alternative control reviews based on the results of the risk assessments, external audits, management studies and other factors,

(6) coordinate and conduct follow-up to ensure material weaknesses are corrected,

(7) review the annual certifications to provide the Commandant with a sound basis for his certification report to the President and Congress, and

(8) complete such projects as the Management Control Plan (MCP), the Corrective Actions Tracking System (CATS), and the High Risk Area report.

b. Chiefs of Offices and special staff divisions at Headquarters, area and district comanders, commanders of maintenance and logistics commands, unit commanding officers, and Coast Guard Activities Europe, shall:

(1) ensure that risk assessments, internal control reviews, and alternative internal control reviews are conducted as directed by the Coast Guard Internal Control Officer and in accordance with guidance provided in this instruction,

(2) designate an individual on their staff to serve as the point of contact for A-123 and coordinator for their command. Notify the Coast Guard Internal Control Officer of the individual's name, business address and phone number upon receipt of this instruction and update the information as changes occur,

(3) ensure the effectiveness of internal control systems operating in an organization for which they have command responsibility. Schedule and take corrective actions to alleviate deficiencies. Evaluate reports of breakdowns in internal controls submitted to them and forward to the Coast Guard Internal Control Officer if significant enough to warrant Commandant attention, and

(4) submit annual certification by 15 September to the Commandant on the adequacy of their internal controls in accordance with the guidance provided in Chapter 5.

4. ACTION. Chiefs of Offices and special staff divisions at Headquarters, area and district commanders, commanders of maintenance and logistics commands, unit commanding officers, and Coast Guard Activities Europe shall comply with the contents of this instruction.

5. REPORTS/FORMS.

   (a) Reports Control Symbol, RCN-5700-1 applies to the Risk Assessment Score Sheet (CG-5430).

   (b) Reproduce locally copies of forms DOT F5100·1, CG-5400 (1-85), CG-5400A (1-85), CG-5400B (1-85), CG-5400C (1-85), located in Chapter 3, and CG-5430 (6-86) located in Chapter 2.

Robert T. Nelson
ROBERT T. NELSON
Chief of Staff

Encl: (1) OMB Circular A-123 (revised)
(2) DOT Order 5100.4B
(3) Description of Event Cycles

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ENCLOSURE (2) DOT Order 5100.4A, Department of Transportation Internal Control and Accounting Systems

ENCLOSURE (3) Description and Examples of Event Cycles, Control Objectives, and Control Techniques

CHAPTER 1

BACKGROUND AND POLICY GUIDELINES

1. **BACKGROUND**

    a. The Office of Management and Budget (OMB) under the Federal Managers' Financial Integrity Act of 1982 and the Accounting and Auditing Act of 1950 require Federal agencies to ensure that internal accounting and administrative controls are effective and meet standards prescribed by the Comptroller General.

    b. Circular A-123 (revised) [Enclosure (1)] is OMB's directive on Internal Controls. A-123 establishes policy on internal controls, and outlines a structured program of mandatory administrative assessment of agencies' internal control systems.

    c. Department of Transportation (DOT) policies and standards on internal controls and accounting systems are outlined in DOT Order 5100.4B [Enclosure (2)].

2. **OBJECTIVES**. The objectives of the A-123 program, and internal controls in general, are to ensure that the Coast Guard:

    a. safeguards against unauthorized use or disposition of financial or other resources,

    b. executes transactions in accordance with authorizations,

    c. maintains reliable financial and statistical records, reports, and other administrative or programmatic data,

    d. adheres to applicable laws, regulations and policies, and

    e. manages all resources, programs, administrative responsibilities efficiently and effectively.

3. POLICY.

a. Coast Guard policy requires compliance with the requirements of OMB Circular A-123 and DOT Order 5100.4B. All levels of management are responsible for ensuring the adequacy of internal controls for protection of Coast Guard resources from fraud, waste or abuse. Managers must establish or change internal controls as necessary to comply with the standards of OMB Circular A-123. Performance appraisals of all personnel, military and civilian, who are responsible for carrying out the internal control systems program, shall reflect their level of responsibility. Risk assessments, internal and alternative management control reviews shall be considered a factor in performance appraisals.

4. DEFINITIONS

a. **Assessable Unit**. A major program, administrative or financial activity, function or subdivision subject to vulnerability assessment.

b. **Control Objective.** A desirable goal or condition for a specific event cycle (example: a program, project or other goal) that reflects the application of the overall objectives of internal control to that specific cycle.

> **Note:** Control objectives are not absolutes. Since the achievement of control objectives can be and are affected by such factors as budget constraints, staffing limitations, consideration of other workload priorities, statgutory and regulatory restrictions, and cost-benefit considerations, the lack of achievement of control objectives does not necessarily represent a defect or deficiency requiring correction. Such limiting factors need to be considered in determining whether there is reasonable assurance that resources are properly managed and safeguarded.

c. **Event Cycle.** The process used to initiate and perform related activities, create the necessary documentation, and gather and report related data; in other words, a series of steps taken to accomplish a task.

d. **Existing Safeguards.** The internal control measures or procedures which are currently in place to prevent or at least to minimize waste, loss, unauthorized use, or misappropriation.

4. e. **General Control Environment.** Various environmental factors (such as management's attitude toward internal control, competence and integrity of personnel, delegation and communication of authority and responsibility, ADP considerations, and others) that can influence the effectiveness of internal controls over program and administrative functions.

f. **Inherent Risk.** The inherent potential for waste, loss, unauthorized use, or misappropriation due to the nature of an activity itself.

g. **Internal Control.** The plan of organization and methods and procedures adopted by management to provide reasonable assurance that: obligations and costs are in compliance with applicable laws; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures are properly recorded and accounted for to permit preparation of reliable reports and maintain accountability over assets.

h. **Internal Control Documentation.** Written policies, organization charts, procedural write-ups, manuals, memoranda, flow charts, decision tables, completed questionnaires, software, and related written materials used to describe internal control methods and measures, to communicate responsibilities and authorities for operating such methods and measures, and to serve as a reference for persons reviewing the internal controls and their functioning.

i. **Internal Control and Alternative Control Review.** A detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost effective manner. An alternative review is a process used to determine overall compliance and may include audits, management studies, or other similar reviews.

j. **Internal Control Standards.** The internal control and accounting standards issued by GAO for use in establishing and maintaining systems of internal control. These standards are applicable to all operations and administrative functions but are not intended to limit or interfere with duly granted authority related to development of legislation, rulemaking, or other discretionary policymaking in an agency.

4. k. **Internal Control System.** The sum of the organization's methods and procedures used to achieve the objectives of internal control. An internal control system is not a separate system within an agency, but rather an integral part of the management processes used by an agency to carry out its programs and activities.

l. **Internal Control Technique.** Processes and documents capable of being used to efficiently and effectively accomplish an internal control objective and thus help safeguard an activity from waste, loss, unauthorized use, or misappropriation.

m. **Material Weakness.** A situation in which the designed procedures, or the degree of operational compliance with them, does not meet the objectives of internal control specified in section II of this chapter.

> **Note:** 'Material Weakness' should not be confused with 'risk'. Risk refers to the relative potential of a program or function for waste, loss, or other abuse; while material weakness is an actual situation where there is no reasonable assurance that waste, loss, etc. is being prevented. This is usually determined from an internal control review, audit, or other evaluation. A program or function could be rated highly vulnerable but have adequate controls such that no material weakness exists.

n. **Risk Assessment.** A **preliminary** evaluation of the **susceptibility** of a program or function to waste, loss, unauthorized use, or misappropriation utilizing a structured evaluation or assessment guide. A Risk Assessment is not conducted in as much depth as an Internal Control Review.

5. RESPONSIBILITIES.

a. Commandant (G-CCS-2) is designated as the Coast Guard Internal Control Officer. The Internal Control Officer will promulgate appropriate directives and coordinate Coast Guard implementation of A-123. The Internal Control Officer is responsible for providing guidance, policy, instructions and training as necessary to ensure Coast Guard compliance with the requirements of A-123 and successful response to A-123 by Coast Guard managers.

b. Area and district commanders, commanders of maintenance and logistics commands, unit commanding officers, CG Activities Europe, and Chief of Offices and special staff divisions shall:

5. b. (1) Ensure that all internal control program requirements, such as Risk Assessments and Internal Control and Alternative Control Reviews, are conducted in accordance with published instructions and schedules.

(2) Designate an individual on their staff to serve as the point of contact for A-123 and coordinator for their command. Notify the Coast Guard Internal Control Officer of the individual's name, business address and phone number upon receipt of this instruction and update the information as changes occur.

(3) Ensure the effectiveness of internal control systems operating in an organization for which they have command responsibility. Schedule and take corrective actions to alleviate deficiences. Evaluate reports of breakdowns in internal controls submitted to them in accordance with paragraph 5.c., below, and forward to the Coast Guard Internal Control Officer any reports which, in their opinion, are of significant gravity to warrant Commandant attention.

c. All Coast Guard personnel, military and civilian, shall comply with the requirements of internal controls established to protect Coast Guard resources from fraud, waste and abuse. **Any significant breakdown of an internal control system should be reported immediately, through the chain of command, to the appropriate manager.**

SEGMENTATION AND RISK ASSESSMENT

SEGMENTATION

Commandant (G-CCS-2) with assistance from Chiefs of Offices and special staff divisions at Headquarters, will segment the Coast Guard into assessable units for conducting Risk Assessments and Internal and Alternative Internal Control Reviews. Assessable units are developed from Coast Guard's organization and functional alignment.

RISK ASSESSMENT

1. RESPONSIBILITIES.

Chiefs of offices and special staff divisions at Headquarters, area and district commanders, commanders of maintenance and logistics commands, commanding officers of Headquarters units, and Commander, Coast Guard Activities Europe shall:

(1) designate an individual on their staff to serve as the point of contact for A-123 and coordinator for their command,

(2) conduct Risk Assessments and complete Risk Assessment Score Sheet (CG-5430), Exhibit 2-A, according to direction provided by the Coast Guard Internal Control Officer and guidelines provided in Chapter 2, for the internal controls of those Assessable Units listed for their organization, and

(3) submit completed Risk Assessment Score Sheets to Commandant (G-CCS-2) biennially by 15 September.

2. GENERAL INFORMATION AND INSTRUCTIONS

a. Risk Assessment. A Risk Assessment is an evaluation of the susceptability of a program or function to unauthorized use of resources, errors in reports or information, and illegal or unethical acts. It is based on considerations of the environment in which the program or function is carried out, the inherent riskiness of the program or function, and a preliminary evaluation as to whether adequate safeguards exist and are functioning.

b. Responsibility for Assessment. Coast Guard managers at Headquarters, Headquarters units, maintenance and logistic commands, in the districts, and at Coast Guard Activities Europe shall conduct Risk Assessments.

2. b. Risk assessments should be conducted by the managers most responsible for, or familiar with, a particular assessable unit. The process of internal control evaluation is an opportunity for managers to examine their internal management practices and policies in a structured manner.

c. Internal Control and Improvement Process. The internal control evaluation and improvement process does not stop with Risk Assessments, since by themselves Risk Assessments do not identify weaknesses or result in improvements. Rather, they are the mechanism with which an agency can quickly determine the relative potentials for loss in its different functions and activities, and then determine whether to schedule those found to be at some risk for Internal or Alternative Control Reviews and corrective actions as necessary.

d. The Assessment Process.

(1) Risk assessments should be performed by one or more individuals assigned to the program activity or function being assessed. Risk assessments must be conducted by Headquarters offices, Headquarters units, maintenance and logistics commands, districts, or Coast Guard Activities Europe for the list of assessable units provided them biennially by Commandant (G-CCS-2).

(2) Complete one Risk Assessment Score Sheet, (CG-5430, RCN-5700.1), biennially, according to the following instructions, for each assessable unit listed.

3. INSTRUCTIONS FOR COMPLETING THE RISK ASSESSMENT SCORE SHEET.

a. The Risk Assessment Score Sheet. The Risk Assessment Score Sheet is used to complete the Risk Assessment process, that is, to determine the status of the General Control Environment, to determine the degree of inherent risk, and to make a Preliminary Evaluation of Safeguards. As an assessor, you are responsible for the accurate completion of the score sheet relating to the activities or functions you have been assigned.

b. Choosing an Answer.

(1) The Risk Assessment Score Sheet has a number of possible scores for each question. To determine the score, read the "Considerations" for the item, review the choices, and pick the choice which most closely depicts the status of the function or activity you are assessing. Examples are provided for each response choice. The choices are

3. b. (1) (cont'd) designed so that you should be able to make a determination from the examples provided. If that is not so, try to reduce your choices to two and then choose. If in choosing, you can't determine which of the two most closely depicts the function or activity you are assessing, choose the answer having the higher score.

(2) After you have determined the proper score, circle the number on the score sheet for the consideration you are addressing which corresponds to the score you have selected. Note that each management consideration on the answer sheet has only the scores which are available for that item. There are no right or wrong answers in the Risk Assessment process. All answers should be based on a straight forward assessment of the function or activity by the evaluator.

(3) Upon completion of the scoring for each function or activity, add the scores and write the total in the appropriate place on page two of the score sheet.

RCN NO. 5700-1

Risk Assessment Score Sheet

Complete one evaluation sheet for each assessable unit using the assessment guide provided.

Title of Assessable Unit: ____.

COMPONENT NUM: __________. **Organizational Unit:**

Prepared by: ____.
(Title/Signature) (Date) (Telephone #)

Approved by: ____.
(Title/Signature) (Date)

Respond to Considerations 1-30 by circling the appropriate answer

1.	RESPONSIBILITIES OF PERSONNEL INVOLVED		1		3		5
2.	WRITTEN PROCEDURES AND INSTRUCTIONS			2	3	4	5
3.	INSTRUMENTS UTILIZED IN THE PROCESS/SYSTEM		1		3		5
4.	INTERACTION ACROSS ORGANIZATIONS			2	3	4	5
5.	SENSITIVITY BY ENTITIES EXTERNAL TO THE DEPARTMENT		1		3		5
6.	NEWNESS OF PROGRAM		1	2	3	4	5
7.	EXPECTED APPROPRIATION FOR THE PROGRAM IN THE NEXT FISCAL YEAR (FY)		1	2	3	4	5
8.	NATURE OF THE PROGRAM	NA	1	2	3	4	5
9.	RECENT CHANGES IN RESOURCE LEVELS		1	2	3	4	5
10.	IMPACT OR SENSITIVITY OF THE PROGRAM ON PERSONS OR ORGANIZATIONS EXTERNAL TO THE DEPARTMENT	NA	1		3		5

Dept of Transp., USCG, CG-5430 (6-86)
LOCAL REPRO

Reverse of CG-5430 (6-86)

11.	APPRECIATION FOR EFFECTIVE INTERNAL CONTROLS		1		3		5
12.	ASSUMED EFFECTIVENESS OF EXISTING CONTROLS		1	2	3	4	5
13.	THE INTERVAL SINCE THE MOST RECENT EVALUATION OR AUDIT		1	2	3	4	5
14.	RECENT INSTANCES OF ERRORS OR IRREGULARITIES		1	2	3	4	5
15.	STATUS OF AUTHORIZING LEGISLATION	NA	1		3	4	5
16.	SCOPE OF WRITTEN AUTHORITY		1	2	3	4	5
17.	TYPE OF ADMINISTRATION			2	3	4	5
18.	ADMINISTRATIVE RESOURCES - STAFF		1		3		5
19.	ADMINISTRATIVE RESOURCES - S & E DOLLARS (Salaries and Expenses)		1		3		5
20.	OPERATIONAL COVERAGE BY WRITTEN PROCEDURES			2	3	4	5
21.	POTENTIAL FOR CONFLICTS OF INTEREST		1		3		5
22.	ADEQUACY OF CHECKS AND BALANCES	NA	1		3		5
23.	PERSONNEL CONSIDERATIONS		1		3		5
24.	ADEQUACY OF REPORT (Particularly Financial Reports)		1	2	3		5
25.	ADP CONSIDERATIONS	NA	1		3		5
26.	EMPLOYEE STANDARDS		1	2	3		5
27.	BUDGETARY AND ORGANIZATION GOALS		1		3		5
28.	TIME CONSTRAINTS		1		3		5
29.	CLASSIFIED MATERIAL		1	2	3	4	5
30.	COSTS VERSUS BENEFITS OF EXISTING CONTROL SYSTEM		1		3		5

TOTAL SCORE = _____________.

4. **Risk Assessment Work Book.**

The following thirty questions provide short descriptions on particular types of internal controls or management activities and outline basic considerations or issues. You are then given several descriptions, **with examples**, of how an internal control or management activity may operate. Choose the description for the internal control or management situation which best fits the activity or function you are evaluating.

QUESTION # 1: RESPONSIBILITIES OF PERSONNEL INVOLVED

CONSIDERATIONS

One factor in any function or activity is the authority of the individuals over the "resource" being protected. That is why there is generally more than one level of review and approval prior to the disposition of the resources.

The basic consideration is whether one person has the authority to dispose of the resource, or is the authority shared with others, each of whom may interrupt or disapprove of the transaction. There is more opportunity for improper resource disposition if only one person controls the action.

Decision-making authority on matters relating to cash are generally multi-level, for example, the processing of time cards is essentially between employee and supervisor. However, one person may make a determination, based on salary history, of the grade and step an individual receives on entering Federal service.

CHOICES AND EXAMPLES:

Multi-employee share responsibility. This situation exists if the transaction process involves more than an employee and his/her supervisor having control over the APPROVE/DISAPPROVE portion of the transaction cycle, for example, the requestor, the immediate supervisor, the upline supervisor(s), the executive officer, and the finance officer, prior to the approval of the proposed obligation of funds. Score 1

Employee/Supervisor Relationship. The employee asks for and the supervisor approves, for example, request for leave. Score 3

Individual Direct Control over the Resource. This exists if one person can request and approve the disposition of the resource, for example request and distribution of supplies. Score 5

QUESTION # 2: WRITTEN PROCEDURES AND INSTRUCTIONS

CONSIDERATIONS

Written procedures provide the benchmark by which managers can review the activity in light of internal control objectives by asking, "What is the Internal Control Objective?" and "Does the procedure provide a means of meeting that objective?" Documentation of procedures in a transaction cycle is the benchmark for most audit, follow-up, evaluation and review.

The basic issue is whether there are written procedures for employees to follow and within general rules, how much discretion is allowed. Usually, the more discretion allowed, the more potential for abuse.

CHOICES AND EXAMPLES:

Specific guidance with no discretion allowed. For example, the time-keeping system or preparation of travel vouchers.	SCORE 2
Specific guidance with some discretion allowed. For example, classifying positions, granting administrative leave, access to personnel files.	SCORE 3
Flexible guidance with significant discretion allowed. For example, conduct of audits, allocation of S & E resources (salaries and expenses), preparation of annual budgets.	SCORE 4
No documented instructions. For example, a transaction cycle in which the disposition of the resource is not controlled by written procedures.	SCORE 5

QUESTION # 3: INSTRUMENTS UTILIZED IN THE PROCESS/SYSTEM

CONSIDERATIONS

An instrument is a document utilized in the approval/disapproval or execution phases of a transaction cycle. **The basic issue is the convertibility of instruments to cash or things suitable for personal benefit.** Many instruments can be converted to personal use.

Can the instrument be realized in cash? Can the instrument be utilized for benefit?

CHOICES AND EXAMPLES:

Non-convertible instruments. Memoranda and letters indicating a determination or approval. These are records of transactions and cannot be exchanged for cash or services.	SCORE 1
Controlled Instruments. Numbered items, convertible to services, not cash. Government meal tickets, GTR's.	SCORE 3
Negotiable instruments. Items directly convertible to cash. Salary checks, checks received by the agency, imprest fund vouchers.	SCORE 5

QUESTION # 4: INTERACTION ACROSS ORGANIZATIONS

CONSIDERATIONS

The greater the number of organizations involved in a transaction cycle, the greater the risk of error. Does the transaction cycle remain within a chain of command or does it cross organization or agency lines of authority and accountability.

CHOICES AND EXAMPLES:

Exclusive to one Functional Office. Classification, telephone change requests.	Score 2
Within two Functional Offices. Procurement requests.	Score 3
More than two Functional Offices. Proposed policy directives, clearance of regulations, information collection.	Score 4
Involvement with other Agencies. Interagency agreements, dealings with state and local governments, professional organizations, Intergovernmental Personnel Assignments (IPA) of systems which involve more than one agency (i.e. payroll, or administrative payment systems).	Score 5

QUESTION # 5: SENSITIVITY BY ENTITIES EXTERNAL TO THE DEPARTMENT

CONSIDERATIONS

The existence of special interests for a function may be indicative that it can be highly susceptible to fraud, waste, abuse or mismanagement. Therefore, consideration should be given to whether the function has been the focus of special attention from any of the following sources:

The President, Congress, or OMB.

Legislative deadlines.

Media Attention.

Litigation.

Special Interest Groups.

CHOICES AND EXAMPLES:

Low level of interest. Minor interest in the function.	SCORE 1
Moderate level of interest. Occasional interest, but not a pressing concern of those managing the function.	SCORE 3
High level of interest. Significant consideration due to the high degree of interest emanating from one or more of the sources above. This situation exists if an employee considers the impact on outside entities virtually everytime he/she performs his/her function.	SCORE 5

QUESTION # 6: NEWNESS OF PROGRAM

CONSIDERATIONS

A program or program-type activity which has been in existence longer can be potentially less vulnerable because procedures for administering its resources have been worked out and in place to a greater degree.

The age of the program or activity refers to the length of time that it has had the same fundamental mission, without major new responsibilities or legislative changes.

CHOICES:

Over 10 years old	SCORE 1
6 - 10 years old	SCORE 2
3 - 6 years old	SCORE 3
1 - 3 years old	SCORE 4
Less than 1 year	SCORE 5

QUESTION # 7: EXPECTED APPROPRIATION FOR THE PROGRAM IN THE NEXT FISCAL YEAR (FY)

CONSIDERATIONS

Programs or activities expending large amounts of money are susceptible to greater degrees of fraud, waste, abuse or mismanagement than programs or activities expending small amounts. Accordingly the level of funding should be considered in assessing the vulnerability of a program or activity.

In completing this item, the assessor should consider the President's Budget Request for the next fiscal year as well as the actions that the Congress has taken, particularly in regard to the Continuing Resolution.

CHOICES:

Zero-Funding	SCORE 1
Up to $5 million	SCORE 2
$5 - $25 million includes programs or activities up to $25 million.	SCORE 3
$25 - $100 million includes programs or activities up to $100 million.	SCORE 4
Over $100 million	SCORE 5

QUESTION # 8: NATURE OF THE PROGRAM

CONSIDERATIONS

An important factor in determining the risk of a particular program to waste, fraud, abuse or mismanagement is the extent to which Federal internal control mechanisms can effectively monitor and influence program operations at the grantee or contractor level. The specific type of program (e.g., a contract or formula or discretionary grant) can impact the extent to which program operations may be susceptible to weaknesses in control procedures.

For example, there are more possible weaknesses which could be the responsibility of program managers in the administration of a discretionary grant program -- where program managers must develop criteria for grant awards, convene a selection panel for new grants, make recommendations for funding, and assist in the final negotiations with successful applicants -- than would be the case of program managers of a block grant or formula grant program where the Federal role is more limited.

CHOICES:

Not Applicable This would include program-type activities which do not involve the awarding of funds (few Coast Guard program-type activities involve awarding grants, but many do involve contracting activities).	SCORE NA
Block Grants	SCORE 1
Formula Grants	SCORE 2
Loans/Grants in Aid	SCORE 3
Contracts	SCORE 4
Discretionary Grants/Fellowships Includes Cooperative Agreements.	SCORE 5

QUESTION # 9: RECENT CHANGES IN RESOURCE LEVELS

CONSIDERATIONS

A program or program activity which has had a funding or staff increase in the last year could be less vulnerable because there are additional resources to carry out the internal control objectives. Conversely, a funding or staff decrease could reduce the amount of effort devoted to internal control objectives.

CHOICES:

Program Reassignment in last 18 months	SCORE 1
Funding or staff increase 0 - 6% from last year	SCORE 2
Funding or staff increase over 6% from last year	SCORE 3
Funding or staff decrease 0 - 6% from last year	SCORE 4
Funding or staff decrease more than 6% from last year	SCORE 5

QUESTION # 10: IMPACT OR SENSITIVITY OF THE PROGRAM ON PERSONS OR ORGANIZATIONS EXTERNAL TO THE DEPARTMENT

CONSIDERATIONS

Federal agency programs and functions often have considerable financial and non-financial impact on persons and organizations external to the agency. Other programs may not involve any monetary award, but can still command significant and widespread interest by the general public and special interest groups. **When a program has such impact, it is likely to be subjected to external pressures which may circumvent systems of internal control.**

The existence of special interests or extraordinary oversight is also a sign of program impact or sensitivity. Therefore, consideration should be given to whether the program activity has been the focus of special attention from any of the following:

- The President, OMB, or Congress
- Legislative mandates or deadlines
- Media attention
- Litigation
- Special Interest groups

Information concerning potential impact can usually be obtained from such sources as internal planning or budget documents, Congressional hearing reports, program descriptions, and media and public interest reports.

CHOICES:

Not Applicable SCORE NA

Low level of Impact or Sensitivity. Total number of individuals or organizations affected are relatively small and special interest groups are nonexistent or have little political leverage. SCORE 1

Moderate Level of Impact or Sensitivity. The program serves moderately sizable numbers of individuals or organizations, and while special interests may be active, they are not a pressing concern for Coast Guard program managers. SCORE 3

High Level of Impact or Sensitivity. Significant impact or sensitivity due to high degree of interest and potential influence of program beneficiaries or their special interest groups. This situation exists when program managers must continuously consider the impact of the program activity on outside entities or individuals. SCORE 5

QUESTION # 11: APPRECIATION FOR EFFECTIVE INTERNAL CONTROLS

CONSIDERATIONS

It is important that organizations and personnel involved in a transaction cycle have an understanding of the roles they play in the cycle, the reasons for the rules they follow, and the necessity for considering those rules in both planning and executing operations. Where there is little appreciation for effective internal control, the likelihood of waste, fraud, abuse and mismanagement increases.

Among the things an assessor must consider are:

What is the management attitude toward the development and maintenance of internal controls?

Does the organizational structure have an appropriate grouping of activities and reporting relationships?

Is top management assured of the competence and integrity of the organization's personnel?

Are there appropriate delegations and limitations of authority?

If any of the above questions cannot be answered in a positive manner, the existing controls are not particularly effective.

CHOICES:

Major Factor. Internal Controls operate at a high level in planning and operations at all organizational levels.	SCORE 1
Moderate Factor. Internal Controls considered in one or more of the following: evaluation of operations, performance appraisals, external requirements.	SCORE 3
Minor Factor. Little to no appreciation of Internal Controls at most levels.	SCORE 5

QUESTION # 12: ASSUMED EFFECTIVENESS OF EXISTING CONTROLS

CONSIDERATIONS

The existence of Internal Controls by themselves does not guarantee protection from waste, fraud, abuse and mismanagement. The controls must be reviewed and improved periodically.

The assessor should be able to estimate the effectiveness and the need for review and improvement of internal controls.

CHOICES:

Highly effective. Controls not likely to require revision.	SCORE 1
Moderately effective. Controls require updating, but revisions not likely.	SCORE 2
Effective. Controls could benefit from minor improvements and revisions.	SCORE 3
Less than effective. Controls in need of more than minor revisions and improvements.	SCORE 4
No existing controls. Need for establishment of a system of Internal Controls.	SCORE 5

QUESTION # 13: THE INTERVAL SINCE THE MOST RECENT EVALUATION, AUDIT OR INSPECTION

CONSIDERATIONS

The longer the interval between systematic operational reviews, the greater the likelihood that system or operational errors will go undetected. It is important, therefore, that all control systems undergo periodic evaluations, audits, inspections or reviews to detect errors and initiate improvements.

When was the last CG, GAO, IG, or other review of this operation conducted?

CHOICES:

Within the last six months	SCORE 1
Between 6 and 12 months	SCORE 2
Between 12 and 18 months	SCORE 3
Between 18 and 24 months	SCORE 4
More than 2 years ago	SCORE 5

QUESTION #14: RECENT INSTANCES OF ERRORS OR IRREGULARITIES

CONSIDERATIONS

Recent errors or irregularities are indications of either a lack of internal controls or ineffectiveness of existing ones. Further, the speed with which these errors are corrected can be an indication of management commitment to minimizing opportunities for fraud, waste, abuse and mismanagement.

In addition to formal findings by GAO, IG, etc., recent instances of bad publicity (newspaper articles) or other criticism (Congress, consumer, client) should also be considered in completing this item.

CHOICES:

No instances in the last 18 months.	SCORE 1
Minor findings or known errors, fully corrected. (Non-monetary findings)	SCORE 2
Major findings or known errors, fully corrected. (Monetary or major system findings)	SCORE 3
Minor findings or known errors, outstanding.	SCORE 4
Major findings or known errors, outstanding.	SCORE 5

QUESTION # 15: STATUS OF AUTHORIZING LEGISLATION

CONSIDERATIONS

The status of the authorizing legislation often has an impact on program stability. Situations involving expiration, reauthorization or a sunset review can expose the program in question to risk of fraud, waste or abuse in its operation.

CHOICES:

Not applicable to this assessable unit	SCORE NA
Relatively stable	SCORE 1
Covered by Sunset	SCORE 3
Reauthorization within 2 years	SCORE 4
Expiration within 2 years	SCORE 5

QUESTION # 16: SCOPE OF WRITTEN AUTHORITY

CONSIDERATIONS

The written authority under which a program or function operates is important from two perspectives:

- The specific authority delegated in writing controls the amount of authority vested in the program's manager(s).
- The legislative or regulatory authority under which the program operates is a limit on agency freedom to administer the program.

CHOICES:

Limited and Precise	SCORE 1
Broad and Precise	SCORE 2
Limited and Vague	SCORE 3
Broad and Vague	SCORE 4
No Written Authority	SCORE 5

QUESTION # 17: TYPE OF ADMINISTRATION

CONSIDERATIONS

How a program is administered often affects the types of control which the Federal government can impose. Generally the more third party involvement, the greater the risk.

CHOICES:

Federal Government (Coast Guard) Only	SCORE 2
Equal Federal Gov't and 3rd Party	SCORE 3
Mostly 3rd Party	SCORE 4
All 3rd Party	SCORE 5

QUESTION # 18: ADMINISTRATIVE RESOURCES - STAFF

CONSIDERATIONS

Are the staff resources authorized to accomplish the assigned mission sufficient to do the job? This question is not asked in order to have each manager decry the amount of staff resources assigned (compared to some ideal he/she would like to have), but rather to elicit how the level impacts on the operation of internal controls in the assessable unit.

CHOICES:

Ample	SCORE 1
Adequate	SCORE 3
Insufficient	SCORE 5

QUESTION # 19: ADMINISTRATIVE RESOURCES - S & E DOLLARS (Salaries and Expenses)

CONSIDERATIONS

Often administration of a program/function depends not only on sufficient staff to do the job but on non-program dollars used to administer their program. This is often in the form of travel money, money for contracts, etc., which are allocated separately from either appropriated program dollars or staffing levels.

CHOICES:

Ample	SCORE 1
Adequate	SCORE 3
Insufficient	SCORE 5

QUESTION # 20: OPERATIONAL COVERAGE BY WRITTEN PROCEDURES

CONSIDERATIONS

To the degree that operational procedures are written, distributed to employees and enforced, the possibilities of mismanagement are reduced. Are routine operations covered by written procedures which are monitored and enforced?

CHOICES:

Extensive and Detailed	SCORE 2
Essentials Only	SCORE 3
Partial Coverage	SCORE 4
No Written Procedures	SCORE 5

QUESTION # 21: POTENTIAL FOR CONFLICTS OF INTEREST

CONSIDERATIONS

This is an area which has received significant attention in recent years. The potential for conflicts of interest on the part of program administrators is one which must be carefully monitored, or program participants and/or the public may lose faith in the fair and impartial administration of government programs/functions.

CHOICES:

Limited	SCORE 1
Moderate	SCORE 3
Substantial	SCORE 5

QUESTION # 22: ADEQUACY OF CHECKS AND BALANCES

CONSIDERATIONS

Checks and balances are utilized so that authority for certain functions is diffused to minimize the potential for waste, fraud, abuse or mismanagement. The assessor, in answering this question, should try to determine, first if checks and balances are appropriate, and if so, are they adequate to protect the resources from manipulation, etc.

CHOICES:

Not Applicable	SCORE NA
Adequate	SCORE 1
Insufficient	SCORE 3
Required but Totally Lacking	SCORE 5

QUESTION # 23: PERSONNEL CONSIDERATIONS

CONSIDERATIONS

One of the most important factors in the successful operation of a system of internal/management control is personnel. If the operating personnel are not qualified and properly trained for the functions they are to execute, the best-designed system of internal/management control may not function in the manner intended. The question speaks only to the qualifications and training of the personnel assigned, not the numbers of personnel assigned.

CHOICES:

Fully Trained and Qualified	SCORE 1
Qualified but require Training	SCORE 3
Unqualified	SCORE 5

QUESTION # 24: ADEQUACY OF REPORTS (Particularly Financial Reports)

CONSIDERATIONS

The accuracy and timeliness of normal recurring reports (particlarly financial reports) are good indicators of a well-run operation.

CHOICES:

Reports are accurate & timely.	SCORE 1
Reports are accurate but usually late.	SCORE 2
Reports are less than accurate, but on time.	SCORE 3
Reports are usually inadequate and late.	SCORE 5

QUESTION # 25: ADP CONSIDERATIONS

CONSIDERATIONS

Many activities are highly dependent on ADP for either operations or providing data or information on which management decisions are made. While use of ADP can save time there are issues of reliability and security which are particularly important when the use of automated equipment is involved. When assessing ADP, consider general and application controls as defined below:

General Controls apply to all processing carried out within a computer installation and are independent of computer applications. Generally, many applications are normally processed in the same installation. General controls include:

Data Center Operations Controls
Security Controls
System Software Controls
Hardware Controls
Distributed Processing and Network Operation Controls
Organizational Controls

Application Controls are primarily concerned with data being processed. Collectively, they form a network of controls in a system to facilitate the production of accurate and reliable information. Certain internal control techniques should be incorporated directly into the application to help ensure accurate and reliable processing. Although these control techniques may be unique to a particular application, they can normally be grouped according to various stages of data processing. The basic application control techniques consist of:

System Design, Development and Modification Controls
Data Origination Controls
Data Input Controls
Data Processing Controls
Data Output Controls

Additional information is provided in DOT's "ADP Internal Control and Vulnerability Assessment Guidelines" dated April 1986.

CHOICES:

ADP is not a factor in this function.	SCORE NA
ADP used for up to 10% of reporting or operational data.	SCORE 1
ADP used for 10% to 50% of reporting or operational data.	SCORE 3
ADP used for more than 50% of reporting or operational data.	SCORE 5

QUESTION # 26: EMPLOYEE STANDARDS

CONSIDERATIONS

Both performance and conduct standards are extremely important as control systems themselves. These systems establish rules of performance or conduct expected of employees. If employees are not aware of or do not adhere to these standards, organizational performance may deteriorate and/or conduct expected in certain circumstances cannot be assured.

CHOICES:

Standards are disseminated and followed.	SCORE 1
Standards are disseminated but adherence is not reviewed.	SCORE 2
Standards are disseminated but adherence is spotty.	SCORE 3
Standards are not disseminated in a manner designed to assure adherence.	SCORE 5

QUESTION # 27: BUDGETARY AND ORGANIZATION GOALS

CONSIDERATIONS

The establishment of both budgetary and organization goals provides employees with benchmarks by which they can measure accomplishment and also set individual goals for personal accomplishment. Where these goals **are not** established, reviewed periodically, updated and disseminated to employees, successful achievement is less likely.

CHOICES:

Budgetary and Organization Goals are established, reviewed periodically, updated and disseminated to employees.	SCORE 1
Goals are established and disseminated but not reviewed and updated periodically.	SCORE 3
Goals have not been established.	SCORE 5

QUESTION # 28: TIME CONSTRAINTS

CONSIDERATIONS

In many activities the requirement to produce under deadline imposes severe time constraints. This can reduce the ability to produce work of consistent quality and may also generate a powerful inducement to end run systems of internal control because of time constraints.

CHOICES:

Time constraints are not a significant factor in operations.	SCORE 1
Time constraints are a factor but only moderately so.	SCORE 3
Time constraints are a significant daily fact of life.	SCORE 5

QUESTION # 29: CLASSIFIED MATERIAL

CONSIDERATIONS

The handling of classified material imposes special responsibilities and requires special controls in an organization. The safeguarding of such material requires more than ordinary precautions on the part of employees of the organizational element.

CHOICES:

The activity generally does not handle classified material.	SCORE 1
The activity handles classified material and there have been no security violations in the past year.	SCORE 2
There have been minor security violations in the past year.	SCORE 3
There have been more than minor violations but practices have been instituted to prevent recurrence.	SCORE 4
There have been more than minor violations and practices to prevent recurrence have not been instituted.	SCORE 5

QUESTION # 30: COSTS VERSUS BENEFITS OF EXISTING CONTROL SYSTEM

CONSIDERATIONS

In some cases there is question as to whether the cost of a control exceeds the benefit. An example would be the potentially high cost of 100% audit of travel vouchers which would result in significantly less saving per voucher than the cost of the audit. The assessor should determine if the cost of an existing control system is worth the benefits obtained.

CHOICES:

The costs of the system(s) are well worth the benefits.	SCORE 1
There is a question as to whether the costs outweigh the benefits.	SCORE 3
The costs do outweigh the benefits and the system should be reviewed.	SCORE 5

CHAPTER 3

INTERNAL CONTROL REVIEWS AND FOLLOW-UP

1. **BACKGROUND**

    a. An internal control review is a detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost effective manner. Potential risks mean fraud, waste and abuse of Government resources and mismanagement of Government programs.

    b. Internal control reviews provide the manager with a beneficial tool which:

        (1) focuses on specific highly vulnerable areas under the manager's control,

        (2) identifies material weaknesses in those areas (if any), and

        (3) plans appropriate corrective action. By pinpointing weaknesses and highlighting the need for corrective action, this process enables the Coast Guard to accomplish its mission more efficiently and thereby make better use of its resources.

2. **OBJECTIVES**. The objectives of internal control reviews are to:

    a. Determine whether adequate internal controls exist and operate as intended,

    b. Plan and schedule corrective actions where deficiencies exist,

    c. Correct deficiencies and develop proper internal controls within an established deadline, and

    d. Maintain internal controls.

3. **RESPONSIBILITIES**

a. Chiefs of Offices and special staff divisions at Headquarters, area and district commanders, commanders of maintenance and logistics commands, commanding officers of Headquarters units, and Commander, Coast Guard Activities Europe shall:

(1) Conduct internal control reviews and report results according to the instructions provided in this chapter.

(2) Report internal control review status to the Commandant (G-CCS-2), quarterly or upon request, on the Corrective Action Record (DOT F5100.1) in Exhibit 3-A.

(3) Submit a Certification of Internal Control Review Results (CG-5400) to the Commandant (G-CCS-2) upon completion. (Exhibit 3-B)

b. The A-123 Coordinators have responsibility to provide guidance during the internal control review to ensure that the review complies with applicable requirements.

c. Area and district commanders, maintenance and logistics commanders, and commanding officers of Coast Guard units shall participate in internal control reviews conducted by operating and support program directors when requested.

d. The Commandant (G-CCS-2) shall:

(1) Assign and schedule internal control reviews based on the results of the risk assessments, and

(2) Coordinate the overall Coast Guard effort for conducting internal control reviews.

INTERNAL CONTROL REVIEW INSTRUCTIONS

1. **INTRODUCTION**. An Internal Control Review (ICR) will encompass a detailed review of those administrative and/or program functions identified as highly vulnerable. The methodology to conduct ICRs is based on G-CCS-2 guidelines comprised of the following six steps:

(1) Identify the event cycles

(2) Analyze the general control environment

(3) Document the event cycle

(4) Evaluate the internal controls within the event cycles

(5) Test the internal controls

(6) Prepare the report

EXHIBIT 3-A

U.S. DEPARTMENT OF TRANSPORTATION
INTERNAL CONTROLS PROGRAM

Corrective Action Record

1. Program Name: ________________________________

2. Event Cycle: ________________________________

3. Nature of Weakness: ________________________________

____

4. Date Management was Notified of Weakness: ____________________

5. Corrective Action Proposed: ________________________________

____

6. Anticipated Correction Date: ________________________________

7. Actual Correction Date: ________________________________

Prepared by: ________________________ (Name) ____________ (Routing Symbol)

DOT F5100.1 (8-83)

EXHIBIT 3-B

DEPARTMENT OF TRANSPORTATION U. S. COAST GUARD CG-5400 (1-85)	CERTIFICATION OF INTERNAL CONTROL REVIEW RESULTS

In accordance with my responsibilities as ______________________________,
(Title)

I have completed an internal control evaluation *(vulnerability assessment and internal control review)* of *(function)* ______________________________ for the year__________.

(Please check appropriate box)

☐ The results of the evaluation indicate that the system of internal control of this function in effect during the year ________, complies with the requirement to provide reasonable assurance that the objectives of internal control were achieved.

☐ The evaluation disclosed material weaknesses indicated in the attached report of ICR results. The report lists weaknesses, planned actions, and schedules for correcting such weaknesses.

☐ Status of actions taken to correct weaknesses identified in prior year's reports are included.

Signature ______________________________

Title ______________________________

Date ______________________________

Attachment:

☐ List of Material Weaknesses and Planned Actions

☐ Status of Actions

BLANK

2. **PROCEDURES**. The following paragraphs provide general guidance, specific options, and ICR procedures.

a. General Guidance. Program managers should designate appropriate resources for performing the ICRs. Constraints on time and available personnel may preclude independent review. An individual or team may perform an ICR. Paragraph 3 of this section prescribes minimum documentation requirements. The reviewers should consult with the A-123 coordinator at regular intervals during the ICR to ensure compliance with applicable requirements.

b. Specific Options. Since the internal control evaluation process is an integral part of the management process, the manager having responsibility for the particular area under review should participate in the ICR. Personnel who are familiar with the program should perform or participate in the review. Another approach may involve a senior specialist, knowledgeable in the area under review, to perform or participate in the ICR. A joint review by a combination of managers and specialists could also perform an ICR. In some instances, the participation of other experts with skills in the functional areas of Management Analysis, Budget, Security and Logistics, Comptroller, Personnel, etc., could benefit the area under review.

c. ICR Procedures. The following procedures represent a G-CCS-2 approved method of conducting internal control reviews. The G-CCS-2 process recommends six steps for conducting an Internal Control Review (ICR):

(1) Identify the event cycles. The first step of an ICR involves identifying the event cycles (the steps taken to get something done) of the program or function under review. G-CCS-2 recommends a flow chart of the event cycles in accomplishing this step. The chart should enable the reviewer(s) to determine the control points during the cycles and to devise tests to determine the effectiveness of the control points. The charts should depict the entire process. If appropriate, a narrative description can supplement the chart to ensure a clear description of the process. Exhibit 3-C, List of Event Cycles Within Program and Administrative Functions (CG-5400A), provides a format for recording the cycles.

The sources of information for identifying event cycles include "Description and Examples of Event Cycles, Control Objectives, and Control Techniques" [Enclosure (3)], the vulnerability assessment for the function, legislation, regulations, policy statements, procedures manuals, management interviews, etc.

2. c. (2) Analyze the General Control Environment. The second step of the ICR requires a narrative description of the environment in which the program or administrative function operates. The reviewer(s) should appraise the general control environment and summarize the positive aspects as well as potential weaknesses.

(3) Document the Event Cycle. The third step involves documenting the event cycles to obtain a thorough understanding of how they operate. This is accomplished by interviewing the persons involved, reviewing existing documentation, observing the activity, and preparing a narrative explanation of the process. The documentation should identify such things as the procedures, the personnel performing the procedures, and the forms and records developed and maintained. G-CCS-2 recommends a review of the completed documentation with the persons providing the information, and, if necessary, tracking one or two transactions through the process. This will assure the accuracy of the documentation and understanding of the cycles.

(4) Evaluate the Internal Controls within the Event Cycles. The fourth step of the review requires an evaluation of the event cycles by reviewing the documentation and deciding whether the existing controls are sufficient. This evaluation should provide reasonable assurance that obligations and costs comply with applicable law; proper safeguards exist for funds, property, and other assets; and proper records exist on revenues and expenditures in order to prepare reliable financial and statistical information. To do this, the reviewer(s) should:

(a) Identify the control objectives of the event cycles and evaluate any achievements. The achievement of control objectives significantly decreases the potential for waste, loss, or other abuse. However, the lack of achievement of control objectives does not necessarily represent a defect or deficiency in internal control. The overall documentation of internal controls must include adequate written documentation of control objectives. Review the documentation of control objectives to determine their completeness, logic, and relevancy to the event cycles.

EXHIBIT 3-C

DEPARTMENT OF
TRANSPORTATION
U. S. COAST GUARD
CG-5400A (1-85)

LIST OF EVENT CYCLES WITHIN PROGRAM AND ADMINISTRATIVE FUNCTIONS

ROUTING SYMBOL

PROGRAM/ADMINISTRATIVE FUNCTION

EVENT CYCLES	COMMENTS

PREPARED BY	DATE
REVIEWED BY	DATE

BLANK

2. c. (4) (b) Determine whether appropriate control techniques exist and operate in an effective and efficient manner. Define control techniques in writing. Review the documentation to determine whether the control techniques provide reasonable assurance that the control objectives operate in a consistent, efficient, and effective manner. The overall documentation of internal controls must include adequate written documentation of control techniques.

Exhibit 3-D, List of Internal Controls, (CG-5400B) provides a format for listing and evaluating the objectives and techniques.

Control objectives are established because a risk exists; implementation of internal control techniques prevent the specific risk from occurring. For example, a payroll system contains the risk of people getting paid for time not worked. An appropriate control objective would be payments made only in return for time actually worked. A control technique would be for supervisors to approve time cards to ensure payment only for actual time worked. It is important to remember that inherent limitations can constrain efforts to maintain effective internal control. Examples include budgetary constraints, statutory limitations, and other management priorities. Consider these constraints when evaluating the appropriateness of the control objectives and techniques.

(c) Identify excessive control techniques. Since the internal control process incorporates cost-benefit concerns, remember that excessive control techniques can create inefficiencies and unnecessary costs. The reviewer(s) should identify and document such instances.

The results of this process identify (a) necessary internal control techniques, (b) control objectives with inadequate control techniques and recommended system corrections and/or (c) unnecessary control techniques that can be eliminated.

(5) Test the Internal Controls. The fifth step in an ICR tests the necessary control techniques to determine whether they function as intended. Select a sample of transactions and review the documentation for those transactions, as well as making other observations and inquiries, and determine whether the specified techniques work as intended. The use

2. c. (5) (cont'd) of various sampling procedures may enhance the effectiveness of this process. For example, the testing of ADP systems may often require the use of advanced review procedures.

Sometimes a specified control technique will appear inadequate or will not function properly. In these instances, the reviewer(s) should evaluate whether personnel are compensating for the shortcoming with other safeguards, or whether compensating controls exist in interrelated systems not subject to review. Identify any inadequate techniques along with recommendations for correcting the problem, i.e., by instituting new controls, improving existing controls, or accepting the risk associated with the shortcoming. Exhibit 3-E, Tests of Internal Controls (CG-5400C), provides a format for documenting the testing procedure.

2. c. (6) Prepare the Report.

(a) Draft Report. The reviewer(s) should prepare a draft report of the results of the ICR and circulate it for comment to all appropriate offices. The report should:

1. Provide an analysis of the program and/or administrative controls.

2. Provide the basis for stating whether or not the controls in effect provide reasonable assurance that waste, loss, or other abuse does not exist or will not likely occur.

3. Identify material weaknesses along with recommendations, including plans and schedules for corrective action.

4. Consider the costs and expected benefits of changes in order to achieve control objectives in a cost-effective manner.

5. Estimate the costs and benefits of suggested improvements so that the implementation of controls does not cost more than it saves.

6. Reflect instances of excessive controls.

Retain supporting documentation, such as notes and flow charts, on file. After reviewing comments on the draft report, make appropriate changes and prepare the final report.

EXHIBIT 3-D

DEPARTMENT OF TRANSPORTATION U. S. COAST GUARD CG-5400B (1-85)	LIST OF INTERNAL CONTROLS	ROUTING SYMBOL

PROGRAM/ADMINISTRATIVE FUNCTION

EVENT CYCLE

CONTROL OBJECTIVES	CONTROL TECHNIQUES	STRENGTH (S) WEAKNESS (W) EXCESSIVE (E)	COMMENTS

PREPARED BY	DATE
REVIEWED BY	DATE

BLANK

EXHIBIT 3-E

DEPARTMENT OF
TRANSPORTATION
U. S. COAST GUARD
CG-5400C (1-85)

TESTS OF INTERNAL CONTROLS

ROUTING SYMBOL

PROGRAM/ADMINISTRATIVE FUNCTION

EVENT CYCLE

NECESSARY CONTROL TECHNIQUES	FUNCTIONING (YES OR NO)	ADEQUATE (YES OR NO)	COMMENTS AND RECOMMENDATIONS

PREPARED BY

DATE

REVIEWED BY

DATE

BLANK

2. c. (6) (b) Final Report. Consider the following questions when reviewing the final report:

1. In what ways is the general control environment inadequate to provide the necessary atmosphere for the appropriate functioning of specific controls?

2. In what ways are necessary control techniques nonexistent or inadequate?

3. In what areas are necessary control techniques not functioning as intended?

4. In what areas are control techniques excessive, thereby fostering a lack of economy or creating inefficiencies?

5. In what ways are executive, legislative, or other management requirements excessive, thereby creating inefficiencies?

3. **Minimum Documentation Requirements for Internal Control Reviews.** For internal control reviews conducted in accordance with the G-CCS-2 procedures, the minimum documentation requirements consist of the final ICR report, and Exhibits 3-C, 3-D and 3-E. Retain any other information, such as flow charts and interview notes, on file. For reviews not conducted in accordance with G-CCS-2 procedures (but which generally comply with G-CCS-2 Guidelines), the minimum documentation requirements consist of the final ICR report, and if available, background information such as notes and charts.

4. **Reporting Internal Control Review Results.** Reports resulting from an ICR should verify that adequate internal controls exist or identify material weaknesses and initiate actions to correct those weaknesses. These reports are necessary to support the Commandant's annual certification to the Secretary in compliance with the requirements of the Federal Managers' Financial Integrity Act of 1982. These reports should provide the Commandant sufficient assurance that the review was conscientiously performed and accurately reflects the condition of internal controls within Coast Guard.

   Report the results to the Commandant, upon completion of an internal control review. Submit certification of the completed review and the ICR results, showing either one of the following:

   a. That no material weaknesses were found.

   b. A list of material weaknesses identified in the review, along with plans and schedules for corrective action.

4. (cont'd) The format for reporting the ICR results includes a certification statement and copies of Exhibits 3-C, 3-D and 3-E. Do not submit copies of the final ICR report unless an urgent need arises for developing internal controls for national programs.

5. **Follow-up Actions**. Risk assessments and internal control or alternative reviews and reports should not be an end in themselves. Management should consider recommendations on a timely basis and take appropriate corrective actions as promptly as possible. G-CCS-2 maintains a formal follow-up system and records the status of ICR's's on Form DOT F5100.1, "U.S. Department of Transportation Internal Controls Program - Corrective Action Record". The system logs and tracks recommendations and target dates, provides assistance for the development of plans for implementing the corrections, and monitors the implementation of scheduled changes. Exhibit 3-A provides the format for recording follow-up actions.

CHAPTER 4

ALTERNATIVE INTERNAL CONTROL REVIEWS AND FOLLOW-UP

1. BACKGROUND

a. The management control process provides for the use of alternatives for full scale internal control reviews. This is done to maximize the use of existing management processes, reduce the workload, and save resources. The use of AICR's also allows managers to integrate existing management review processes into the internal management control process. Audits and evaluations conducted within the past two years may fulfill the requirements of an AICR, PROVIDED the reports include reasonable coverage of internal control concerns (e.g., improving the management and safeguarding of resources), and comply with the Commandant's Guidelines. Also, reviews required and completed under OMB Circulars A-76, A-110, A-127, and A-130 may be used as an AICR. Major control problems discovered through the reviews conducted to meet the requirements of these circulars are to be reported in the annual statement of assurance

b. Inspection reports, control reviews, audits conducted by independent review staffs and other management reviews or consultant studies may also be used as AICR's. The major control problems discovered through these reviews should also be reported in the annual statement of assurance.

c. An AICR must meet the essential criteria of an internal control review and include testing of controls in operation to be an acceptable alternative for management control purposes. This may require some additional work by the component manager to address the management control criteria which the alternative control review may not have addressed.

d. The results of the AICR are reported in a manner similar to the procedures outlined in Chapter 3 for internal control reviews. Managers may identify all or any number of the findings and recommendations which pertain to systems of management control.

2. DOCUMENTATION:

a. Documentation should be prepared and maintained to verify the completion of the evaluation and the results and conclusions reached. Documentation should include:

(1) The officials participating in the review;

(2) The controls examined;

2. a. (3) The extent and type of controls performed;

(4) The analyses of the tests conducted;

(5) A description of any weakness found;

(6) The actions recommended to correct the weakness; and

(7) The timeframe needed to correct the weakness.

3. RESPONSIBILITIES

a. Chiefs of Offices and special staff divisions at Headquarters, area and district commanders, commanders of maintenance and logistics commands, commanding officers of Headquarters units and Commander, Coast Guard Activities Europe shall:

(1) Conduct alternative internal control reviews and report results according to the instructions provided in this chapter or in Chapter 3 as appropriate.

(2) Report alternative internal control review status to the Commandant (G-CCS-2), quarterly or upon request on the Corrective Action Record (DOT F5100.1) identified in Exhibit 3-A.

(3) Submit a Certification of Alternative Internal Control Review Results (CG-5400) to the Commandant (G-CCS-2) completion. (Exhibit 3-B)

b. The A-123 Coordinators have responsibility to provide guidance during this process to ensure that the review complies with applicable requirements.

c. Area and district commanders, maintenance and logistics commanders and commanding officers of Coast Guard units shall participate in alternative internal control reviews conducted by operating and support program directors when requested.

d. The Commandant (G-CCS-2) shall:

(1) Assign and schedule alternative internal control reviews based on the results of the risk assessments, and

(2) Coordinate the overall Coast Guard effort for conducting internal control reviews.

CHAPTER 5

ANNUAL CERTIFICATION

1. BACKGROUND

a. As required by the Federal Managers' Financial Integrity Act of 1982, the Secretary must report annually to the President and the Congress on compliance with the FMFIA. Consequently, the Commandant must send to the Secretary written annual certification of the Coast Guard's compliance with the Act.

b. To provide a sound basis for the certification, Chiefs of Offices and special staff divisions at Headquarters, area and district commanders, commanders of maintenance and logistics commands, unit commanding officers and Coast Guard Activities Europe must provide the Commandant with reasonable assurance of the adequacy of their internal control systems annually.

2. RESPONSIBILITIES

a. Chiefs of Offices and special staff divisions at Headquarters, area and district commanders, commanders of maintenance and logistics commands, unit commanding officers, Coast Guard Activities Europe shall submit annual certification to Commandant (G-CCS-2) by 15 September, on the adequacy of their internal controls.

b. Commandant (G-CCS-2) shall review the certifications to provide the Commandant, by 15 October, with a sound basis for his certification report to the Secretary on 1 November.

3. PROCEDURES

Complete the annual certification memo shown in Exhibit 4-A and submit, by 15 September, to Commandant (G-CCS-2). Include any applicable reports listing material weaknesses, planned actions, and schedules for correcting such weaknesses.

NOTE: This reporting requirement is separate from those described in Chapter 3 and Chapter 4. Internal Control Review reports must be completed biennially, in addition to the annual certification.

ANNUAL CERTIFICATION TO THE COMMANDANT ON INTERNAL CONTROLS

Chiefs of Offices/Special Staff Divisions/Area and District Commanders/Commanders of Maintenance & Logistics Commands/Unit Commanding Officers,/Coast Guard Activities Europe

Commandant (G-CCS-2)

Ref: (a) COMDTINST M5700.7B, Internal Control Systems Program Manual

In accordance with reference (a), I have directed an evaluation of the system of internal accounting and administrative control (risk assessment and internal/alternative control review) of the ______________________________ for the FY year ______.

(Please check all appropriate boxes)

☐ The results of the evaluation indicate this __________ complied with all internal control requirements for the past year.

☐ The evaluation disclosed material weaknesses indicated in the enclosed report. The report lists weaknesses, planned actions and schedules for correcting such weaknesses.

☐ Status of actions taken to correct weaknesses identified in prior year's reports are included.

☐ Reviews of OIG/GAO audits disclosed material weaknesses indicated in the enclosed report. The report lists weaknesses, planned actions and schedules for correcting such weaknesses.

Enclosure:

☐ List of material weaknesses and planned actions disclosed during evaluation

☐ Status of actions

☐ List of material weaknesses and planned actions disclosed by review of OIG/GAO audits

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

August 4, 1986

CIRCULAR A-123
Revised

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Internal Control Systems

1. Purpose. This circular prescribes policies and procedures to be followed by executive departments and agencies in establishing, maintaining, evaluating, improving, and reporting on internal controls in their program and administrative activities.

2. Rescission. This circular replaces Circular A-123, Revised, "Internal Control Systems," dated August 16, 1983.

3. Background. The Budget and Accounting Act of 1950 requires the head of each department and agency to establish and maintain adequate systems of internal control.

   The Federal Managers Financial Integrity Act, P.L. 97-255, (hereafter referred to as the Integrity Act), amended the Budget and Accounting Procedures Act of 1950 and requires that internal accounting and administrative control standards be developed by the General Accounting Office, annual evaluations be conducted by each executive agency of its system of internal accounting and administrative control in accordance with guidelines established by the Director of the Office of Management and Budget; and annual statements be submitted by the heads of each executive agency to the President and the Congress on the status of the agency's system of internal controls.

4. Policy. Agencies shall establish and maintain a cost-effective system of internal controls to provide reasonable assurance that Government resources are protected against fraud, waste, mismanagement or misappropriation and that both existing and new program and administrative activities are effectively and efficiently managed to achieve the goals of the agency. The system shall comply with the Integrity Act and the internal control standards developed by the General Accounting Office and implemented by this circular. All levels of management shall be involved in ensuring the adequacy of controls. Internal control does not encompass such matters as statutory development or interpretation, determination of program need, resource allocation, rulemaking, or other discretionary policymaking processes in an agency.

5. Definitions. For the purpose of this circular, the following terms are defined:

   a. Agency -- any department or independent establishment in the executive branch.

b. Agency Component -- a major program, administrative activity, organization, or functional subdivision of an agency.

c. Internal Control Objective -- specific end to be achieved by control techniques used in a component. Each objective is to take into consideration the nature of the component and the requirements of this circular. Limiting factors such as budget constraints, statutory and regulatory restrictions, staff limitations, and the cost-benefits of each control technique are to be considered in determining desired internal control objectives.

d. Internal Control Documentation -- written materials of two types.

(1) System documentation includes policies and procedures, organization charts, manuals, memoranda, flow charts, and related written materials necessary to describe organizational structure, operating procedures, and administrative practices; and to communicate responsibilities and authorities for accomplishing programs and activities. Such documentation should be present to the extent required by management to effectively control their operations.

(2) Review documentation shows the type and scope of review, the responsible official, the pertinent dates and facts, the key findings, and the recommended corrective actions. Documentation is adequate if the information is understandable to a reasonably knowledgeable reviewer.

e. Internal Control Guidelines -- the guidelines issued by the Office of Management and Budget (OMB) in December 1982, entitled "Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government," or as they may be modified subsequently. These guidelines, present a suggested approach, and should adapted to meet the needs of the individual agencies provided that any such adaptation remains in compliance with this circular.

f. Internal Control Evaluation -- a detailed evaluation of a program or administrative activity to determine whether adequate control techniques exist and are implemented to achieve cost-effective compliance with the Integrity Act. Control evaluations are of two types.

(1) Internal Control Review is a detailed examination of a system of internal controls using the methodology specified in the Internal Control Guidelines. All reviews should produce written materials documenting what was done and what was found. See 5(d), Internal Control Documentation.

(2) Alternative Internal Control Review is a process such as Circular A-130 computer security reviews, Circular A-127 financial system reviews, Inspector General audits, and other management and consulting reviews to determine that the control techniques in an agency component are operating in compliance with this circular. Such alternative reviews must determine overall compliance and include testing of controls and the development of required documentation.

g. Internal Control Standards -- the standards developed by the General Accounting Office, and published in "Standards for Internal Controls in the Federal Government," October 31, 1984. Implementation of the standards should be in accordance with this circular, consistent with agency needs for sound cost-effective internal control systems.

h. Internal Control System -- the organization structure, operating procedures, and administrative practices adopted by all levels of management to provide reasonable assurance that programs and administrative activities are effectively carried out in accordance with the objectives of the Integrity Act and this circular.

i. Internal Control Techniques -- the management processes and documents necessary to accomplish an internal control objective.

j. Management Control Plan (MCP) -- a brief written plan which summarizes the agencies risk assessments, planned actions, and internal control evaluations to be undertaken to provide reasonable assurance that controls are in place and working and is used to manage Integrity Act implementation.

k. Material Weakness -- a specific instance of non-compliance with the Integrity Act of sufficient importance to be reported to the President and Congress. Such weakness would significantly impair the fulfillment of an agency component's mission; deprive the public of needed services; violate statutory or regulatory requirements; significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; or result in a conflict of interest.

l. Reasonable Assurance -- a judgment by an agency head based upon all available information that the systems of internal control are operating as intended by the Integrity Act.

m. Risk Assessment -- a documented review by management of a component's susceptibility to waste, loss, unauthorized use, or misappropriation. Risk assessments are of two types:

(1) vulnerability assessments as provided in the guidelines, and

(2) alternative procedures tailored to agency circumstances.

n. Testing -- procedures to determine whether internal control systems are working in accordance with management internal control objectives.

6. Responsibility. The head of each agency is responsible for ensuring that the design, installation, documentation, evaluation, and improvement of internal controls, and issuance of reports on the agency's internal controls are in accordance with the requirements of the Integrity Act and this circular.

a. A senior official shall be designated in each agency who shall be responsible for coordinating the overall agency-wide effort to comply and evaluate compliance with the Integrity Act and this circular.

b. Heads of agency components are responsible for developing and administering the systems of internal controls in their units. This responsibility includes reporting to the agency head each year on the compliance of the internal control systems in their component with the requirements of the Integrity Act and this circular. Quality controls are to be established to assure the accuracy of reports to the agency head.

c. The Inspector General (IG) or the senior audit official where there is no IG, through a program of audits and investigations, is an integral part of the agency's internal control process. Routine evaluations of internal controls should be included within the scope of internal audits and reflected in the resultant reports. The reports are to be included within the sum of all information available to managers for their consideration in making the reasonable assurance determination for use in the annual internal control statement.

d. In addition, the IG or senior audit official should be consulted in the internal control process. The IG should provide technical assistance in the agency efforts to evaluate and improve systems affected by this circular, and may advise the agency head whether the agency's review and evaluation process has been conducted consistent with this circular. Consultation and the provision of technical advice by the IG during agency planning efforts should not preclude the IG from independently making any reviews or audits or otherwise limit the authority of the IG.

7. Objectives of Internal Control. The objectives of internal control apply to all program and administrative activities. Internal control systems are to provide management with reasonable assurance that:

   a. Obligations and costs comply with applicable law.

   b. Assets are safeguarded against waste, loss, unauthorized use and misappropriation.

   c. Revenues and expenditures applicable to agency operations are recorded and accounted for properly so that accounts and reliable financial and statistical reports may be prepared and accountability of the assets may be maintained.

   d. Programs are efficiently and effectively carried out in accordance with applicable law and management policy.

8. Required Agency Actions. Each agency shall meet the following requirements in a cost-effective manner.

   a. Maintain a current internal control directive assigning management responsibility for internal controls in accordance with this circular and the Internal Control Guidelines with the following provisions. Provide for coordination on internal control matters among the designated internal control official, heads of agency components, program managers and staffs, and the IG office or its equivalent. Establish administrative procedures to enforce the intended functioning of internal controls. Require performance agreements, for each Senior Executive Service and Merit Pay or equivalent employee with significant responsibility for internal controls, which result in recognition for positive internal control accomplishments such as timely correction of internal control weaknesses and appropriate action for violations of internal controls.

   b. Develop a Management Control Plan (MCP) or plans to be updated annually. The primary purpose of an MCP is to identify component inventory, to show risk rating of component (high, medium, low), and to provide for necessary evaluations over a five-year period. Material weaknesses and other areas of management concern may also be monitored through the plan. High risk components and material weaknesses must be acted upon during the first year of the plan. The plan should be based upon the schedule of actions in each major component, and identify the senior managers responsible. Management should utilize the plan for monitoring progress and ensuring that planned actions are in fact taken. MCP's are intended to be part of each agency's overall planning process and at a minimum should be linked to activities under A-127 and A-130. The first MCP should be issued and in effect by December 31, 1987.

c. Make risk assessments to identify potential risks in agency operations which require corrective action or further investigation through internal control evaluations or other actions. These may follow the vulnerability assessment procedures in the Internal Control Guidelines or may be based on a systematic review building on management's knowledge, information obtained from management reporting systems, previous risk assessments, audits, etc. Management should update its risk assessment of agency components at least once every 5 years and as major changes occur. Risk assessment on new or substantially revised programs should occur as part of planning for implementation and the results reflected in the MCP. Risk assessments are to be considered as part of developing the MCP.

d. Make internal control evaluations using the procedures in the Internal Control Guidelines or alternative reviews to determine whether the internal control system is effective and is operating in compliance with the Integrity Act and this circular. These reviews should identify internal controls that need to be strengthened or streamlined. The composite of all information that management relies upon to judge their systems effectiveness must include information on the results of tests of their operating internal control systems.

e. Implement corrective actions identified by agency internal control evaluation efforts on a timely basis. A formal followup system should be established that records and tracks recommendations and projected action dates, and monitors whether the changes are made as scheduled. The tracking system should be made part of broader agency management reporting systems whenever feasible.

9. Reporting. By December 31 of each year, the head of an agency subject to P.L. 97-255 (31 U.S.C. 3512) shall submit a statement to the President and to Congress as of the close of the fiscal year: stating whether the evaluation of internal controls was conducted in accordance with this circular, and whether the agency's system of internal controls taken as a whole complies with the standards developed by the General Accounting Office and implemented through this circular and provides reasonable assurance that programs are effectively carried out in accordance with applicable law; reporting the material weaknesses, if any, in the agency's system of internal controls, however identified; and containing a plan for correcting material weaknesses.

Instructions to be followed in preparing this report will be published in supplemental guidance provided by OMB.

10. Effective Date. This circular is effective upon publication.

11. Inquiries. All questions or inquiries should be addressed to the Financial Management Division, Office of Management and Budget, telephone number 202/395-3993.

12. Sunset Review Date. This circular shall have an independent policy review to ascertain its effectiveness three years from the date of issuance.

James C. Miller III
Director

Internal Control Guidelines

This supplement to the 1982 Internal Control Guidelines is intended to clarify their applicability and to assist agencies in determining risk of fraud, waste, and loss; and rapidly identifying and correcting material weaknesses in management controls.

Compliance with the Internal Control Guidelines is not mandatory, provided agencies adopt alternative procedures of equivalent efficacy. These agency procedures must determine relative risk of fraud, abuse, and other losses in agency programs and administrative activities; and also identify and correct material weaknesses in agency internal control systems.

Since agency managers have the responsibility for improving controls, Circular A-123 requires the use of a management control plan to ensure efficient procedures, integration with other management processes, and compliance with the circular.

Management Control Plans (MCPs)

Each agency is required by Circular A-123 to develop a five-year MCP to plan and direct the process for reviewing risk, and identifying and correcting material weaknesses in internal control systems. Because the MCP is primarily a document to manage overall agency efforts under the circular, superfluous detail should be avoided. MCPs must involve senior managers. MCPs should fully utilize managerial knowledge and judgment within a simple, structured process featuring clear, reasonably complete documentation.

Items to be included in the MCP include all components in the inventory, the name of the official responsible for Circular A-123 compliance within the component, management's assessment of the relative risk of the component, year reviews of component internal control systems are planned to be completed. Material weaknesses identified, year identified, and year corrected or scheduled for correction may also be included.

Though the MCP should be updated annually, a complete new MCP is not required. An example of an MCP is attached.

Alternative Internal Control Reviews

In order to streamline the process of reviewing internal control systems and to better involve program and administrative managers, Circular A-123 encourages agencies to use alternatives to the internal control review process specified in the Internal Control Guidelines.

The requirements that ACIRs must meet include compliance with Circular A-123, and sample testing of controls in operation. In responding to these requirements, agencies may use questionnaires, checklists, model control systems, and so on. In part these requirements may be met by using existing agency management reporting and review processes -- including reviews made under OMB Circulars A-76, A-127, and A-130; as well as reviews, audits, management studies, and consultant studies.

U.S. Department of Transportation

Office of the Secretary of Transportation

ORDER

DOT 5100.4B

4-16-91

Subject: DEPARTMENT OF TRANSPORTATION MANAGEMENT CONTROL SYSTEMS

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1. PURPOSE. This Order establishes policies and standards for Secretarial Offices and Operating Administrations to comply with the requirements of Section 2 of the Federal Managers' Financial Integrity Act (FMFIA) of 1982.

2. CANCELLATION. This Order cancels DOT 5100.4A, Department of Transportation Internal Control and Accounting Systems, dated 11-7-83.

3. REFERENCES.

   a. The Federal Managers' Financial Integrity Act of 1982 (P.L. 97-255), 31 U.S.C. 1105, 1113, and 3512, which requires that the head of each executive agency conduct an annual evaluation and provide an annual report to the President and the Congress on the agency's system of management controls.

   b. OMB Circular A-123, Internal Control Systems, dated 8-4-86; OMB Internal Control Guidelines, dated 12-82; and General Accounting Office (GAO) guidance contained in Title 2, Appendix II, Internal Control Standards, which prescribe policies and standards for executive departments.

   c. OMB Circular A-127, dated 12-19-84, and DOT 2300.3A, dated 5-15-86 (both entitled "Financial Management Systems"), which implement Section 4 of the FMFIA and address financial management/accounting systems.

   d. OMB Circular A-11, Preparation and Submission of Budget Estimates, dated 7-90.

   e. OMB Circular A-110, Grants and Agreements With Institutes of Higher Education, Hospital, and Other Nonprofit Organizations, dated 7-1-76, which promulgates standards for obtaining uniformity among Federal agencies in the administration of grants and other agreements with various organizations.

DISTRIBUTION: All Secretarial Offices
All Operating Administrations

OPI: Office of Financial Management

f. OMB Circular A-130, Management of Federal Information Resources, dated 12-12-85.

g. Secretarial memorandum, Delegation of Authority for Annual Reporting Requirements of the FMFIA, dated 3-21-83.

h. Department of Transportation publication, ADP Internal Control and Vulnerability Assessment Guidelines, dated 4-86.

4. APPLICABILITY. This Order applies to all program and administrative functions of each agency (for example, accounting, grants management, operating functions such as flight control and aircraft inspection, personnel administration, procurement, etc.). It also applies to all levels of management. While this Order encompasses all agency operations, it does not limit nor is it intended to interfere with authority related to the development of legislation, rulemaking, or other discretionary policy-making within the Department.

5. DEFINITIONS. For the purpose of this Order, the following terms are defined:

a. Component. A major program, administrative activity, organization, or functional subdivision of a Secretarial Office or Operating Administration. A component was formerly referred to as an assessable unit.

b. Event Cycle. A group of related steps or actions within a function or sub-function. These steps or actions are connected by significant starting and finishing points.

c. Management Controls. The organization, methods, and procedures adopted by management to provide reasonable assurance that funds, property, and other assets are properly accounted for and safeguarded against fraud, waste, abuse, mismanagement, or misappropriation; and revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the proper maintenance of accounts and the preparation of reliable financial reports. A management control was formerly referred to as an internal control and pertains to program, administrative, accounting, and financial management areas.

d. Management Control Documentation. Written materials consisting of two types:

(1) System documentation. Includes policies and procedures, organization charts, manuals, memoranda, flow charts, and related written materials necessary to describe organizational structure, operating procedures, and administrative practices; and to communicate responsibilities and authorities for accomplishing programs and activities.

(2) Review documentation. Reflects the type and scope of review, the responsible official, pertinent dates and facts, key findings, and the recommended corrective actions.

e. Management Control Evaluation (MCE). A documented evaluation of a program or administrative component to determine whether adequate control techniques exist to achieve cost-effective compliance with the FMFIA. There are two types of evaluations.

(1) Management Control Review (MCR). A detailed examination of a system of management controls. A management control review was formerly referred to as an internal control review.

(2) Alternative Management Control Review (AMCR). A process such as Office of Inspector General (OIG) audits, GAO audits, other management reviews conducted in-house or by contractor, Circular A-130 computer security reviews, and Circular A-127 financial system reviews. An AMCR was formerly referred to as an alternative internal control review.

f. Management Control Objectives. The specific objective to be achieved by using control techniques within a component.

g. Management Control Plan (MCP). A written plan that includes a component inventory and summarizes an organization's risk assessments, planned actions, and management control evaluations scheduled to ensure adequate controls are in place.

h. Management Control System. An organization's structure, operating procedures, and administrative practices adopted by management to provide reasonable assurance that programs and administrative activities are effectively and efficiently carried out.

i. Management Control Techniques. The management processes and documents necessary to achieve a management control objective.

j. Material Nonconformance. A specific instance of noncompliance with Section 4 of the FMFIA in an accounting or financial management system.

k. Material Weakness. A specific instance of noncompliance with Section 2 of the FMFIA in program or administrative systems. Such a weakness significantly impairs the fulfillment of an agency's or a component's mission; deprives the public of needed services; violates statutory or regulatory requirements; significantly weakens safeguards against fraud, waste, abuse, mismanagement, or misappropriation, or results in a conflict of interest.

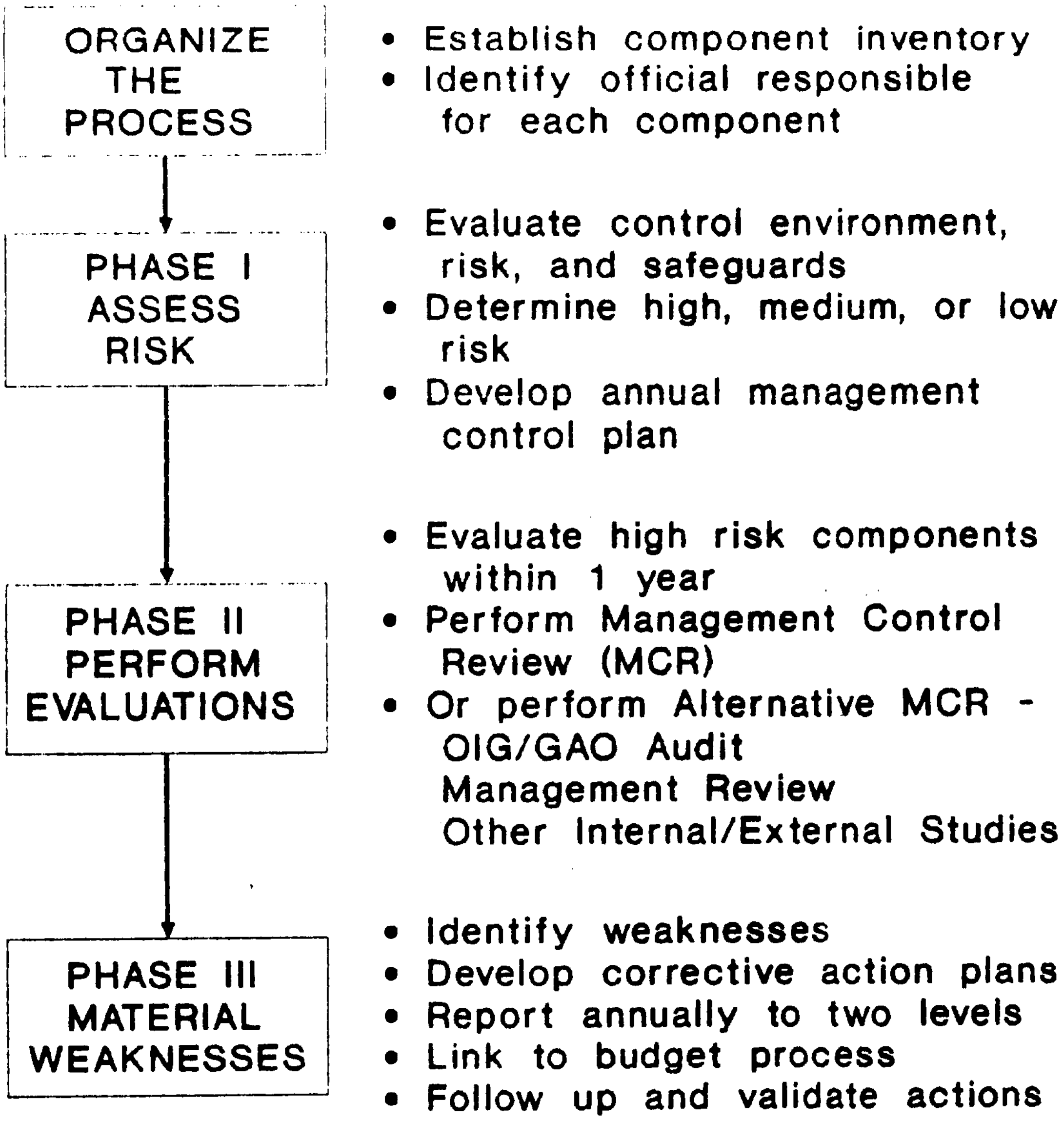
l. Reasonable Assurance. A judgment based upon all available information that the systems of management control are operating as intended by the FMFIA.

m. Risk Assessment. A documented review by management of a component's degree of susceptibility to fraud, waste, abuse, mismanagement, or misappropriation. A risk assessment was formerly referred to as a vulnerability assessment.

n. Testing. Procedures used to determine whether management controls are working in accordance with the management control objectives.

6. POLICY. Secretarial Offices and Operating Administrations shall establish a system of management controls to provide reasonable assurance that their resources are protected against fraud, waste, abuse, mismanagement, or misappropriation. The management control system shall be cost effective and comply with the principles and standards prescribed by this Order.

7. FMFIA PROCESS. This process is composed of various steps which are discussed in the following paragraphs. An overview of the process is illustrated in Figure 1.


ORGANIZE THE PROCESS
PHASE I ASSESS RISK
PHASE II PERFORM EVALUATIONS
PHASE III MATERIAL WEAKNESSES

- Establish component inventory
- Identify official responsible for each component

- Evaluate control environment, risk, and safeguards
- Determine high, medium, or low risk
- Develop annual management control plan

- Evaluate high risk components within 1 year
- Perform Management Control Review (MCR)
- Or perform Alternative MCR -
  OIG/GAO Audit
  Management Review
  Other Internal/External Studies

- Identify weaknesses
- Develop corrective action plans
- Report annually to two levels
- Link to budget process
- Follow up and validate actions

Figure 1

a. Organize the Process. Each Secretarial Office and Operating Administration shall maintain a complete component inventory, ensuring that they are properly sized to facilitate reviews. The component inventory shall include:

(1) All nonpolicy activities and functions, such as an imprest fund operation, the issuance of security badges, or library services. This does not include those activities and functions encompassing such policy matters as statutory development or interpretation, determination of program need, resource allocation, rulemaking, or other discretionary policy-making processes.

(2) The name of the official accountable for the management controls within each component.

b. Assess Risk. An assessment shall be made of a component's control environment, risks, and safeguards in place to protect Government resources. The risk assessment enables the manager to analyze the general control environment, identify and evaluate safeguards (or controls) in place to protect the Government resources entrusted to him or her, and assign a risk rating.

(1) Detailed procedural guidance for preparing a DOT risk assessment is provided in the DOT Management Control Guide. In addition, automatic data processing (ADP) installations may refer to the OST ADP Internal Control and Vulnerability Assessment Guidelines, which is based on the GAO's Audit Guide: Evaluating Internal Controls in Computer-Based Systems, dated June 1981.

(2) Develop an MCP. Each Secretarial Office and Operating Administration shall develop a management control plan summarizing an organization's risk assessments, including a schedule for planned actions and management control evaluations. Detailed procedural guidance for developing and maintaining an MCP is provided in the DOT Management Control Guide.

c. Perform MCEs. MCEs shall be conducted on a continuing basis to identify the need to strengthen or streamline management controls. Any areas determined to be high risk shall be evaluated within 1 year after so identified. Classified or secure activities shall be included in the evaluation process and persons participating in the evaluations shall have the necessary security clearances and ensure that all documentation is appropriately classified and handled. There are two types of MCEs: management control reviews, which examine a process, identify the management controls, and test the controls to ensure their adequacy; and alternative management control reviews, which allow a manager to use existing review processes, such as IG audits or management reviews, to evaluate the status of management controls. Detailed procedural guidance is provided in the DOT Management Control Guide.

d. Identify Material Weaknesses. Material weaknesses may be identified by management, the OIG, or the GAO and shall be categorized as meeting either OMB or Departmental materiality criteria. Those weaknesses meeting OMB criteria are included in the report to the President and the Congress, while those weaknesses meeting only Departmental criteria are included in the annual report to the Secretary. Detailed descriptions of the materiality criteria are provided in Figures 2 and 3.

(1) Resolve Disagreements. If there is a disagreement between an Operating Administration or Secretarial Office and the Office of Financial Management, OST, on the classification of a problem as a material weakness, every effort shall be made to resolve the difference between representatives of the involved organizations. If resolution does not occur, the issue shall be referred to the Assistant Secretary for Administration. If the difference cannot be resolved at that level, it shall be elevated to the Deputy Secretary and the Secretary for resolution.

(2) Report Grantee-Related Material Weaknesses. Weaknesses of this type shall be reported as material weaknesses when the materiality criteria are met and there is sufficient evidence that the organization provided either inadequate grantee program guidance or program monitoring for conformance to Federal regulations.

(3) Establish and Maintain a Tracking System. Each Secretarial Office and Operating Administration shall establish and maintain the Corrective Action Tracking System (CATS), which has been established to record and track material weaknesses until all the required corrective actions are completed.

OFFICE OF MANAGEMENT AND BUDGET MATERIALITY CRITERIA

A material weakness under Section 2 **must** meet one or more of the following criteria:

- merits the attention of the agency head/senior management, the Executive Office of the President, or the relevant Congressional Oversight Committees;
- exists in a majority of agency components or in a major program or activity;
- risks or results in the actual loss of either $10 million or 5 percent of the resources of a budget line item; or
- reflects adversely on the credibility of the agency report to the President and the Congress when subsequently made public.

A material weakness is also defined as a weakness that:

- impairs significantly the fulfillment of an agency's or component's mission;
- deprives the public of needed services;
- violates statutory or regulatory requirements;
- weakens significantly the safeguards (controls) against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; or
- results in a conflict of interest.

Each material nonconformance under Section 4 **must** meet one or more of the following criteria:

- merits the attention of the agency head/senior management, the Executive Office of the President, or the relevant Congressional oversight committee;
- prevents the primary accounting system from centrally controlling financial transactions and resource balances;
- prevents compliance of the primary accounting system, subsidiary system, or program system with OMB Circular A-127.
- results in an actual material misstatement (either 5 percent or more of a budget line item or $10 million) in reports required by OMB, the Treasury Department, or the Congress.

Figure 2

DEPARTMENT OF TRANSPORTATION
MATERIALITY CRITERIA

Departmental criteria provides for the reporting of weaknesses that:

- result in an actual or alleged fraud of at least $5,000 traceable to a management control weakness;
- prevent or are likely to prevent substantial achievement of a component's program, administrative, or financial objectives. Where the objectives are financial, a weakness would generally be considered material if it has resulted or is likely to result in a loss or waste of resources amounting to $500,000 or 5 percent of the program's value.
- have resulted or could result in adverse publicity or embarrassment to the Department which diminishes its credibility or reputation;
- has or could have an adverse impact on the public or third parties;
- is brought to the attention of the Assistant Secretary, Administrator, Commandant, the Executive Office of the President, or the relevant Congressional oversight committees outside the normal management control review process;
- result or could result in violation(s) of statutory or regulatory requirement; for example, Prompt Payment Act, Antideficiency Act, etc.;
- create or could create a conflict-of-interest situation; or
- a Secretarial Officer, Administrator, or Commandant considers reportable to the Secretary.

Figure 3

(4) Prepare the FMFIA Annual Report. Each Secretarial Office and Operating Administration shall prepare an annual report on its system of management controls. The information then is consolidated by the Office of Financial Management into two reports: the report to the President and the Congress, and the internal report to the Secretary.

(5) Validate Corrective Actions. Secretarial Offices and Operating Administrations shall ensure that a material weakness is, in fact, corrected before so stating. Management shall document:

(a) the actions taken to correct the material weakness;

(b) the validation process used to verify that corrective actions were taken; and

(c) assurance that the actions taken are satisfactory, cost efficient, economical, and effective.

(6) Link Management Control and Budget Processes. OMB requires that agencies develop budget estimates for the correction of high risk areas, in accordance with OMB Circular A-11, Preparation and Submission of Budget Estimates. Additionally, when the correction of material weaknesses requires budgetary resources, management should ensure that these requirements are coordinated with, and included in, the budget process.

8. FREQUENCY OF ASSESSMENTS, REVIEWS, AND REPORTING.

a. Risks Assessments. Risk assessments shall be conducted at least once every 3 years.

b. Management Control Plan (MCP). The MCP shall be submitted annually to the Office of Financial Management, OST. A midyear update is also required.

c. Management Control Evaluations. The Secretarial Offices and Operating Administrations shall conduct MCEs on an ongoing basis to determine the adequacy of management controls within their organizations.

d. Corrective Action Tracking System (CATS) Report. The Secretarial Offices and Operating Administrations shall provide the status of actions required to correct material weaknesses and nonconformances triannually to the Office of Financial Management, OST.

e. High Risk Area Report. The Secretarial Offices and Operating Administrations shall submit information on areas designated by the OMB or the OIG as "high risk" to the Office of Financial Management, OST, with the FMFIA annual report, due November 1. A midyear update is also required. Some high risk areas relate directly to one or more material weaknesses, while other high risk areas are broadly defined and have not been identified as material weaknesses.

f. Annual Report. The Secretarial Offices and Operating Administrations shall provide their FMFIA annual reports to the Secretary, through the Assistant Secretary for Administration, by November 1.

9. RESPONSIBILITIES.

a. The Assistant Secretary for Administration shall provide direction and guidance on management control systems and retains management authority to assure compliance with the requirements of the FMFIA, OMB Circular A-123, and GAO standards.

b. The Office of Financial Management, OST, shall provide program guidance and assistance to the Secretarial Offices and Operating Administrations.

c. Secretarial Officers and Heads of Operating Administrations shall be responsible for the respective management control programs within their organizations, as delegated by the Secretary. Specifically, Secretarial Officers and Heads of Operating Administrations shall:

(1) ensure that management control systems are established in accordance with this Order;

(2) ensure that the system of management controls is properly documented;

(3) provide adequate resources to evaluate the system of management controls;

(4) prepare and carry out the management control plan;

(5) develop detailed procedures, training, and reporting requirements necessary to review, establish, maintain, test, improve, and report on management control systems within their organization;

(6) ensure the timely monitoring and correction of weaknesses; and

(7) ensure compliance by specifying manager accountability through program objectives, goals, and performance standards.

d. Managers within the Secretarial Offices and Operating Administrations shall be responsible for the adequacy of management controls within their functional areas to ensure the protection of the Government resources entrusted to them.

e. The Inspector General shall:

(1) provide technical assistance, as necessary, in the implementation of this Order;

(2) participate in the Department's management control process and aid the Assistant Secretary for Administration in developing criteria and guidelines; and

(3) perform, in an oversight capacity, the following types of evaluations:

(a) review of the Department's management control plan and its implementation;

(b) assessment of the performance, completion, and followup of risk assessments, MCRs and AMCRs to ensure that these activities adequately fulfill the Department's obligations under the requirements of the FMFIA; and

(c) review the status of management controls in conjunction with internal audits.

10. PERFORMANCE PLANS. Performance plans of managers in the Senior Executive Service, Merit Pay, or equivalent managers with responsibility for management controls should recognize

the maintenance of effective management controls and other management control accomplishments, such as timely correction of management control weaknesses.

11. PROCEDURES. Detailed guidance on all procedures required under Section 2 of the FMFIA, such as preparing risk assessments, conducting management control evaluations, and preparing the annual FMFIA report, are contained in the DOT Management Control Guide. The Guide is issued by the Office of Financial Management, OST.

12. IMPLEMENTATION. Where appropriate, Operating Administrations should develop additional guidance required to implement this Order and provide a copy of that guidance to the Office of Financial Management (M-80) within 6 months of the date of this Order.

FOR THE SECRETARY OF TRANSPORTATION:

Melissa J. Allen
For the Assistant Secretary
for Administration

DESCRIPTION AND EXAMPLES OF EVENT CYCLES, CONTROL OBJECTIVES, AND CONTROL TECHNIQUES

This Appendix lists event cycles, control objectives, and control techniques in two broad categories: program and administrative. Programs are generally authorized by specific legislation or are a part of legislative authority and may be unique to a specific element in USCG. Examples include Aids to Navigation, Ice Operations, Search and Rescue, Marine Safety, and Military Readiness and Operations. Administrative components, on the other hand, are generally common to all offices, are procedure oriented, and exist to support programs. Examples include Engineering, Personnel, Legal Support, Research and Development, and Command, Control, and Communications. Because of these distinctions, the approach to conducting internal control reviews will necessarily be different for each type of component. Some components, contain the characteristics of both program and administrative components. Consequently, either the program or administrative approach to conducting internal control reviews would be applicable to these components. The reviewer should choose the approach that best suits his/her needs.

I. Program Components. Programs have certain common event cycles, control objectives, and control techniques, as listed below. This list is not intended to be all inclusive.

A. Event Cycles. The event cycles listed below are common to most programs. Due to the nature of these event cycles they should, as a minimum, be included in the internal control review.

1. Planning.
2. Budgeting.
3. Execution.*
4. Reporting.
5. Administration.

*This event cycle would be different for each program because it would include any and all the activities that are necessary to achieve program objectives. For example, a typical research program might require instrument development, field testing, and laboratory or computer analysis to ensure proper execution.

B. Control Objectives. The control objectives listed below are examples of generalized objectives that would meet GAO standards. Objectives for most programs would be written specifically for that program.

1. Planning

    a. Planning process is documented and clearly stated.
    b. Plans are clearly stated and reflect Department and USCG Office mission.
    c. Plans reflect efficient use of resources.
    d. Plans include time frames for completion of activities.

2. Budgeting

    a. Budget goals and objectives are clearly defined.
    b. Budget accurately reflects planned use of resources.
    c. Budget justifications are used as a tool to assess progress in achieving stated goals.
    d. Obligations do not exceed allocations/limitations.

3. Execution

    a. Program is executed according to plan.
    b. Program is monitored periodically.
    c. Deviations from plan are reported in time to avoid unnecessary delays and costs.
    d. Execution is effective and efficient.

4. Reporting

    a. Outputs are according to plan.
    b. Outputs are of a high quality.
    c. Reports are accurate.
    d. Reports are timely.

5. Administration

    a. Lines of Authority and responsibility are clearly defined and documented.
    b. Fund control is maintained in an effective manner.
    c. Property is properly utilized and safeguarded.
    d. Resources are utilized efficiently and effectively.
    e. Effective system of review is in place and is followed.

C. Control Techniques. The control technique examples listed below are general. They will have to be expanded, and in some cases combined, to meet specific control objectives. In addition, some techniques may be repeated for different objectives. For example, peer review might be a control technique for objectives in the executing and reporting cycles.

- Legislative requirements.
- Multi-year plans.
- Management implementation plans.
- Planning Proposals.
- Program analysis papers.
- Program strategy papers.
- Production goals.
- Budget estimates.
- Budget justifications.
- Annual budget review.
- Project Management plans/Major Systems Acquisitions.
- OMB Circulars.
- OST guidelines (Directives/Manuals).
- USCG guidelines (Directives/Manuals).
- Planning, Programming, and Budget (PPB) process.
- Operational plans.
- Financial plans.
- Organizational charts/Functional Statements.
- Position descriptions/Critical Job Elements.
- Performance standards.
- Program review and evaluation.
- Periodic financial reports.
- Periodic progress reports.
- Quality control procedures.
- Data standards.
- Industry standards.
- Peer review (internal and external).
- Management information systems.
- Mid-year review.
- Year-end closeout.
- Preventive maintenance.
- Equipment modernization program.
- Property control system.
- Annual Property Inventory.

II. Administrative Components

Administrative components are procedure oriented, and the procedures within each administrative component are different. Consequently, a generalized approach to identifying event cycles, control objectives, and control techniques cannot be applied to administrative components as it was to program components.

The event cycles, control objectives, and control techniques listed below are unique to one admistrative component, cash management. The list is not intended to be exhaustive - it is shown here as an example of how an internal control review of an administrative component might be approached. In addition, the control objectives and control techniques are unavoidably broad. An actual review will demand more specific and categorical control objectives and control techniques.

A. Event Cycles. The following are some of the cash management event cycles:

1. Billing.
2. Collecting.
3. Depositing.
4. Procuring.
5. Disbursing.

B. Control Objectives. Listed below are some of the generalized control objectives for two of the cash management event cycles:

1. Billing

   a. Identification of debtor and related debt is prompt.
   b. Billing is timely, uniform, and accurate.
   c. Billing is properly supported.

2. Collecting

   a. Amounts due are collected when due.
   b. Amounts collected are controlled and safeguarded.
   c. Collections are promptly processed.
   d. Necessary reconciliations are performed.

C. Control Techniques. Many of the control techniques listed under program concepts (paragraph I.C. of this Exhibit) are applicable here. The following are some additional control techniques for the cash management component. Some techniques will have to be combined or expanded to meet specific control objectives. For example, separation of duties is a control technique for several objectives in the billing, collecting, depositing, procuring, and disbursing event cycles.

- Separation of essential duties.
- Systematic document flow.
- Control documentation.
- Sufficient support documentation.
- Proper use of forms.
- Proper processing of forms.
- Proper distribution of forms.
- Use of receipts.
- Use of prenumbered forms.
- Use of cash register tapes.
- Proper authorizations.
- Proper approvals.
- Adequate supervision.
- Processing standards.
- Existence of system checks.
- Adequate physical facilities.
- Adequate physical equipment.

- Use of suspense account.
- Preaudit of vouchers.
- Designation of accountable officers.
- Reconciliation of internal reports.
- Reconciliation of Treasury reports.
- Use of statistical sampling (if applicable).
- Periodic reviews.
- Supervise cash counts.